# DEPARTMENT OF PUBLIC SERVICE

## STAFF WHITE PAPER

# COMPETITIVE COST ONSETS, EXOGENOUS COSTS AND BELL ATLANTIC/NYNEX MERGER SAVINGS

**Released January 2001**

CASE 00-C-1945 – **Proceeding on Motion of the Commission to Consider Cost Recovery by Verizon, New York, Inc. fka New York Telephone Company and Modification of Performance Regulatory Plan Under Merger Standards and to Investigate the Future Regulatory Framework.**

## I. SUMMARY

Verizon New York, Inc. (formerly New York Telephone Company) has filed requests for recovery of $128 million in competitive cost onsets and $646 million in exogenous costs. This report presents Staff's recommendations relative to these Verizon requests as well as the company's estimates of merger savings associated with the Bell Atlantic/NYNEX merger. Further, the report also addresses the disposition of funds related to the Regulatory Asset Recovery (RAR) Plan and an accounting of the company's employee pension plan. The Staff report recommends that the Commission:

a) adjust the company's request for recovery of competitive cost onsets from $128 million to $116 million,

b) adjust the company's request for recovery of exogenous costs from $646 million to $121 million,

c) adjust the company's estimate of BA/NYNEX merger savings for each year from September 1997 to August 2002,

d) deny the company's request for recovery of exogenous costs and competitive cost onsets because the merger savings more than offset these costs, and

e) reject the company's proposal to use the revenue stream of $53 million associated with the RAR plan to partially recover exogenous costs, since merger savings are available to offset these costs.

## II. BACKGROUND

### Performance Regulatory Plan

On August 16, 1995, the Commission approved[1] the

[1] Opinion No. 95-13, Case 92-C-0665 (August 16, 1995).

Performance Regulatory Plan (PRP) for New York Telephone Company (Verizon).[1] The PRP covers a seven-year period beginning September 1, 1995 and ending August 31, 2002.

Under the PRP, Verizon is permitted to recover or required to flow back the impacts related to legislative tax changes affecting only utilities, costs associated with jurisdictional separations changes and cost changes due to Commission mandates. These costs are exogenous to the company's control and not covered by the general inflation provisions of the PRP.

Bell Atlantic/NYNEX Merger

In 1997, the Commission approved the merger of Bell Atlantic and NYNEX, subject to certain specified conditions.[2] The BA/NYNEX Merger Order modified the PRP by adopting new standards for review of requests for recovery or deferral of any costs including exogenous costs, cost onsets related to the opening of competitive markets, and revenue losses from access charge reductions. Specifically, the Commission provided,

> Our determinations on such requests will include consideration of whether the company's conduct has promoted the development of competition within the state, whether consumers have benefited from competition, including price reductions greater than contained in the PRP, and

[1] New York Telephone also did business under the name Bell Atlantic New York or BA-NY during this time. For simplicity, we will refer to the company as "Verizon" throughout this paper.

[2] Opinion No. 97-8, Cases 96-C-0603 et al., NYNEX-Bell Atlantic Merger, (issued May 30, 1997), incorporating Order Approving Proposed Merger Subject To Conditions (issued March 21, 1997).

> whether consumers have shared in the cost savings resulting from the merger.[1]

The Commission specifically noted that these standards would "ensure that anticipated savings and other benefits of the merger are appropriately flowed through to customers."[2] The Merger Order clarified that recovery of exogenous costs under the PRP was not automatic, but rather discretionary.[3]

Further, the merger order provided the Commission the authority to terminate or modify the PRP at the fifth year checkpoint, based upon the same standards for reviewing cost recovery.

OSS Development Costs

On January 31, 1997, Verizon filed for recovery of about $67 million of costs for the development of an operational support system (OSS) interface so that competitive local exchange carriers could access Verizon ordering systems, as part of Phase 2 of the Unbundled Network Elements proceeding.[4] Both the Administrative Law Judge's Recommended Decision and a Staff Report appended to it raised a number of concerns regarding Verizon's request. These related not only to what the Judge termed "traditional conditions

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[1] March 21, 1997 Merger Order, p. 8.

[2] Id.

[3] March 21, 1997 Merger Order, p. 7.

[4] Cases 95-C-0657, 94-C-0095 & 91-C-1174, First Network Elements Proceeding, Panel Testimony on Behalf of New York Telephone Company, January 31, 1997.

to cost recovery," but also the legal standards for recovery of such costs under the PRP and the NYNEX/Bell Atlantic merger order.[1] In December 1997, the Commission ordered that the costs be denied for the interim, but gave the company two years to make another filing.[2]

On December 22, 1999 Verizon again filed for recovery of OSS development costs. The OSS development costs allocated to New York for which Verizon is seeking recovery doubled since 1997, from approximately $67 million to about $125 million (for 1996 through 2000). Verizon also requests to recover $2.8 million for other competitive cost onsets.[3] Verizon's filing addresses merger savings as part of this request for cost recovery.

Exogenous Cost Filings by Bell Atlantic

Until its most recent (June 1, 2000) exogenous cost filing, Verizon has submitted annual accountings of its exogenous costs but has not been able to calculate merger savings by which the costs should be offset. Having made its BA/NYNEX merger savings filing in December 1999, the company believes it has now met the prerequisites to seek recovery of exogenous costs.

The most recent data submitted by Verizon on exogenous costs was contained in the June 1, 2000 filing. In total, the company seeks recovery of $646 million in what it alleges are exogenous costs due to PSC mandates.

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[1] Cases 95-C-0657, et al., Recommended Decision on Phase 2 Issues (issued October 2, 1997) at 50, 52 & Appendix B.

[2] Opinion 97-19, Cases 95-C-0657, et al., First Network Elements Proceeding - Phase 2, (issued December 22, 1997).

[3] See Appendix A for a description of these "other competitive cost onsets."

Bell Atlantic/GTE Merger

The Commission approved the merger of Bell Atlantic with GTE in August 1999. The order approving this merger contained language regarding the standards by which requests for cost recovery would be judged similar to the standards of the Bell Atlantic-NYNEX merger order:

> Bell Atlantic-New York, Inc. (BA-NY) shall specifically identify overall Bell Atlantic/GTE merger-related savings, and those savings attributable to New York, in connection with the fifth year checkpoint of the Performance Regulatory Plan for New York Telephone Company and in connection with BA-NY requests for recovery of exogenous costs or merger related cost onsets.[1]

Renewal of PRP

Verizon had the option to terminate the PRP at the end of the fifth year (August 31, 2000) or, alternatively, opt to extend the term for two additional years. On June 30, 2000

[1] Case 98-C-1443 - Petition of Bell Atlantic Corporation for Approval of Agreement and Plan of Merger with GTE Corporation, Order Granting Approval of Merger (issued August 12, 1999), p. 7.

Verizon New York, Inc. filed for a two-year extension of the PRP from September 1, 2000 through August 31, 2002.[1]

In its June 30, 2000 filing electing to extend the PRP, Verizon also filed a plan for the disposition of the revenue streams, expense credits and accumulated deferral revenue balance associated with the Regulatory Asset Recovery Plan along with an accounting of its employee pension plan. In sum, the company proposes to use a $53 million revenue stream to offset exogenous costs.

Current Status

The three matters at issue here are Verizon's requests: (1) for recovery of competitive cost onsets; (2) for recovery of exogenous costs; and (3) to allow it to use the $53 million revenue stream to offset exogenous costs. As noted previously, recoveries of these costs and the use of the revenue stream are subject to the cost recovery standards set forth in the BA/NYNEX merger.[2]

[1] Extension of the plan also required the company to reduce rates by $25 million in September 2000 and another $25 million in September 2001. On June 1, 2000 the company filed its proposal for a $25 million dollar rate reduction and in July 2000 Verizon filed a rate proposal to pass back to ratepayers approximately $23 million in funds from the intrastate portion of the profit from the sale of Bellcore. In August 2000 the Commission consolidated these reductions and directed Verizon to file a $50 million rate reduction for basic line charges. Cases 92-C-0665 & 97-C-1297, Order Directing Rate Reduction (issued August 30, 2000).

[2] A Verizon vs. Staff comparison regarding the calculation of Exogenous Costs, OSS Costs and Merger Savings is included as Appendix B.

# III. BA/NYNEX MERGER STANDARDS

## Merger Standards -- Verizon Position

Verizon's position on BA/NYNEX merger standards is set forth in its December 1999 filing to recover OSS development costs. Verizon submits it has met each of the merger standards.

Verizon contends it has promoted the development of competition (Standard 1), by:

- Not using the regulatory process to impede entry into the local market.
- Not challenging the Commission's pro-competitive decisions in court.
- Not opposing certification by the Commission of hundreds of new market entrants.
- Not opposing the lifting of general restrictions on resale.
- Agreeing to the PRP commitments designed to ensure development of competition.
- Voluntarily agreeing to physical collocation.
- Agreeing to the Bell Atlantic/NYNEX merger conditions.
- Agreeing to uniform OSS interfaces for the entire Bell Atlantic footprint.
- Accepting the terms of its Section 271 Pre-filing Statement (including third party testing of OSS).
- Accepting the Performance Assurance Plan.
- Cites Commission Evaluation of Section 271 Application.

Verizon further contends customers have benefited from competition (Standard 2) via:

- The PRP's requirement of a $50 million diffusion fund for advanced services.
- Improvement in service quality over the last few years.
- Reduction in rates greater than the levels mandated by the PRP.
- Capital investments bringing Verizon's Customer Trouble Report Rate (CTRR) in line with the overall CTRR for the merged Bell Atlantic region.

Finally, Verizon contends customers have shared in the cost savings resulting from the Bell Atlantic/NYNEX merger (Standard 3) due to the following actions taken by the company:

- Hiring more than 1,000 employees in service-related areas (in fulfillment of its pledge to hire 750-1,000 employees to improve service quality).
- Rate reductions below the levels provided by the PRP.
- Not passing any OSS development costs to customers.
- Holding a $28 million gain on the sale of a building for customers' benefit.[1]
- The development of uniform OSS systems across the entire Bell Atlantic footprint.
- The purchase of 1095 Avenue of Americas which reflects Verizon's commitment to maintain a headquarters in New York City.

Thus, Verizon claims customers have already benefited from the

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[1] Verizon notes that consolidation of work activities pursued as part of merger efforts allowed it to free up this building and sell it for a profit.

merger savings.

Verizon provided an estimate of net cost savings resulting from the merger of Bell Atlantic and NYNEX for the years 1997-2000. The company estimated that annual merger savings would reach $1.1 billion by the third year following the merger. Verizon estimates its intrastate share of the annual cost savings to be $219.5 million by the year 2000 based on an historic allocation of costs. For the years 1997 through 2001, the merger savings are expected to be $708.8 million. Verizon estimated one-time merger costs to be $129.2 million for the period 1997 to 2001, resulting in $579.6 million of net merger savings.

The company reduced this estimate of cost savings to account for what it claims are additional costs resulting from its acceptance of the conditions of the Commission's merger order. Specifically, Verizon asserts that the merger order required the company to hire 750 to 1,000 additional employees to address service quality issues and to invest an additional $1 billion in service-related infrastructure improvements (Merger Commitment or Service Quality Improvement Plan). The company claims these additional "costs" virtually offset the net merger cost savings.

Merger Standards - Party Comments

BA-NY's December 22, 1999 filing was published in the New York State Register on March 22, 2000 and comments were received from the Attorney General (AG), the Consumer Protection Board (CPB) and a group of CLECs that submitted comments jointly (AT&T, WorldCom Inc., Rhythms Links Inc., Sprint Communications Company L.P., Covad Communications Company, the CLEC Coalition, Northpoint Communications, Inc., and the CLEC Alliance - referred to collectively as "the CLECs").

Both CPB and the AG argue that Verizon's filing fails to comply with the standards for cost recovery required by the merger orders. They contend that most of the consumer "benefits" and efforts to foster competition claimed by the company are either the result of Commission directives issued prior to the merger order, or are a quid pro quo for other benefits the Commission allowed Verizon. As a result, they conclude none of the consumer benefits touted by Verizon substantiate sharing of the $360 million in merger savings that Verizon admits. CPB adds that Verizon invoked its competition-related activities before the merger was approved and states the Commission was well aware of BA-NY's activities up to that time. Thus, when conditioning future cost recovery on conduct that promotes competition, the Commission could only have been considering the company's future conduct.

## Merger Standards - Staff Adjustments[1]

While Staff believes Verizon has taken significant steps to meet the first two standards -- promotion of competition and consumer benefit from competition -- Staff excepts to the company's position regarding the third standard -- consumer sharing of merger cost savings. Verizon contends that savings have been offset to meet merger "commitments" regarding service quality and that therefore there are no further savings to share with consumers.[2]

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[1] A summary of Staff adjustments to Verizon merger savings is included in Appendix C.

[2] The up-front implementation costs associated with the merger have pushed out the date at which the net gains associated with the merger have materialized. Net merger savings have only recently become available. Thus, neither the company, nor ratepayers, could have received a benefit from merger savings as yet.

Staff has made six adjustments to the company's estimate. Staff's adjusted estimate of Verizon's annual intrastate merger cost savings is $489 million by the third year following the merger, the sixth year of the PRP, and $530 million in the seventh year of the PRP. Staff has also identified other savings that the company did not include in its analysis, such as property tax savings from real estate consolidations. However, we have not quantified these adjustments, which may make Staff's estimate conservative.

Staff's first adjustment reverses the company's reflection of "service quality improvement costs." It is inappropriate to reduce merger savings for these expenses, since these expenditures reflect the company's PRP service commitments. The Commission had been concerned with the quality of the company's customer service for several years.[1] As a result, the company committed to incur these costs in order to reach acceptable levels of customer service under the PRP.[2]

Moreover, the service quality commitments, and specifically the hiring of 750 to 1,000 employees, were made by NYNEX in advance of the approval of the merger and were touted by the company as one of the benefits to be expected from its approval.[3] By including these conditions in the merger order, the Commission simply held the new Bell Atlantic to the commitments that it had already made in public. This adjustment increases the 1997-2001 cost savings by $526 million during the PRP.

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[1] Merger Order, Page 3.

[2] Letter from Paul LaCatoure, Vice President, NYNEX, to Richard Stannard, Director, Communications Division, NYDPS, July 10, 1996.

[3] Merger Order, Page 5.

Staff's second adjustment increases the merger cost savings by $289 million during the PRP and reflects Verizon revenue enhancement projections that were quantified by Staff during the original Bell Atlantic merger proceeding. Verizon excludes any revenue enhancements from its calculation of merger savings, contending that the merger order only required the company to identify "cost" savings. The company asserts that the order says nothing about possible revenue enhancements. As a result, Verizon believes the question of possible revenue enhancements resulting from the merger is not relevant to this proceeding.

Staff disagrees with the company's narrow interpretation of the Commission's merger order. Given that the majority of the projected "cost savings" identified in the merger order pertained to the company's own estimates of margin opportunities and other revenue synergies, it would be incorrect to characterize the monetary benefits associated with the merger as deriving solely from decreases in expenses. Instead, the Commission used "savings" and "cost savings" interchangeably to refer to the net revenue benefits of the merger.[1]

In fact, Verizon seems to agree with the Commission's general interpretation of "cost savings" when it seeks recovery

[1] The Commission relied throughout on a net revenue estimate of $908 million calculated by Staff, which included revenue enhancements identified by Bell Atlantic. Compare Opinion No. 97-8, Appendix B at 18 ("Staff's panel estimated that over the remaining term of the PRP, the merger will generate an additional $908 million of savings in New York"), Id., Appendix B at 18 n. 2 (Staff's "intrastate cost savings figure [of $908 million]" was not challenged by Bell Atlantic), id. at 25 n. 1 (same), and id. at 24-25 ("Staff estimates that the operational efficiencies and cost savings cited by Petitioners will generate an additional $908 million in revenue attributable to New York State over the remaining life of the PRP.") (emphasis added).

of certain exogenous costs that include lost revenues (opportunity costs). The company would not have included these reductions in revenue if the term "cost" were limited solely to expenses. In order to be consistent with the merger order and the company's own exogenous cost filings, revenue synergies from the merger must be considered in the calculation of benefits associated with the merger.

Staff's adjustment is based on the company's revenue synergy projections at the time of the merger, because the company has refused to provide updated numbers. It may be that some of these revenue synergies are no longer possible or that some of these synergies (both expense savings and revenue opportunities) are not allocable to the intrastate jurisdiction. However, absent support for any revision of the original projections, the company should be held to its original synergy projections.

The third staff adjustment increases the company's merger cost savings by $78 million during the PRP. The company's merger cost savings assume no force reductions relating to union employees. A review of the support for the company's calculation of merger savings indicated that the company did not quantify force reductions below certain levels in the organization chart. As a result, we conclude Verizon did not capture all of the merger savings resulting from force reductions.

In addition, the company revised its retirement incentive plan (RIP), which was scheduled to end in August 1998, to allow eligible union employees an opportunity to elect to retire by the end of 1999. The offer to extend the RIP should be considered a direct result of the merger. As the merged company consolidated operations to eliminate duplicate functions, it is logical to assume there would be a reduction in the number of management and union employees. Verizon recognized the reduction relating to management employees, but failed to address the reduction in union employees. Staff's adjustment corrects this shortcoming.

Our fourth adjustment increases Verizon's estimate of merger cost savings by $86 million during the PRP. The company provided Staff access to the analyses performed by the Merger Integration Teams (MITs) which the company claims are the supporting documentation for its quantification of merger savings. However, our review found discrepancies that indicate Verizon understated merger savings by $20 million and $55 million in 1997 and 1998, respectively. Until Verizon is able to reconcile the differences between its presentation and the MITs' analyses, we will rely on the MIT analyses provided to us to estimate the merger savings for 1997 and 1998. In order to estimate the proper level for 1999 and 2000, we have assumed that the difference between the company's presentation and the documented savings in the MIT analyses for 1997 and 1998 will continue into 1999 and 2000.

Verizon applied a 25% rate to the expected wage savings to determine estimated benefits and tax savings. Staff's fifth adjustment corrects the loading rate to 31% and thereby increases the company's estimated merger savings by $35 million during the PRP. The MIT analyses indicated the company considered various benefit and payroll tax loading rates to apply to the expected wage savings, ranging from 24% to 35%. The loading rate chosen by Verizon did not include payroll taxes. Since payroll taxes have a direct correlation to the number of employees, the company should have included payroll taxes in the loading rate to more accurately reflect the ratio of benefits and taxes to wages.

Our sixth and final adjustment allocates 5% rather than 14% of the savings to non-regulated operations, which increases the company's merger cost savings by $91 million during the PRP.

The company allocated approximately 14% of the estimated savings to non-regulated operations. The MIT analyses indicated that only 5% of the savings relate to non-regulated operations because those activities are smaller and currently operate more independently, and thus, do not benefit as much from the consolidation of systems or programs.

## IV. COMPETITIVE COST ONSETS

### Competitive Cost Onsets -- Verizon Position

In addition to updating the OSS cost estimates made in Phase 2 of the UNE proceeding, Verizon contends that its December 22, 1999 filing addresses all of the concerns raised by the Commission, ALJ, and Staff in Phase 2 of the UNE proceeding.[1]

Verizon proposes to recover $125.4 million for competitive cost onsets allocated to New York State intraLATA services. The company's starting point for the updated cost estimates was the amount recorded in a work order established in 1996 for tracking OSS development costs.[2] The company's exhibit,

[1] In the Second UNE Proceeding (Case 98-C-1357), Verizon has indicated that it does not know the costs associated with OSS for line sharing, because it is still engaged in discussions with its vendor concerning he needed OSS enhancements. Verizon further proposed that the rate for OSS for line sharing be set at zero subject to true-up once the relevant costs were determined. The Commission's May 2000 order in the case (Opinion No. 00-07) found that approach reasonable, but noted specifically that the recovery of these line sharing OSS costs would be subject to the same conditions imposed on OSS cost recovery generally, going back to Phase 2 of the First Network Elements Proceeding. Verizon has petitioned for rehearing on this issue (Petition filed June 26, 2000).

[2] Verizon has been providing Staff with monthly reports of the expenses recorded in the work order and the Office of Accounting and Finance has been tracing the amounts in the reports to the Footnote is continued on next page.

as revised February 18, 2000, showed $288.2 million[1] of estimated costs recorded in the work order at December 31, 1999. First, subtracting about $3.5 million applicable to development costs for operator services capabilities to get $284.7 million, Verizon determined the amount to be recovered in New York as follows:

**Verizon Determination of OSS Development Costs**
**Calculation of NY's Share of OSS**
**($ Millions)**

| | |
|---|---|
| Base Expenditures per Work Order | 284.7 |
| Less: Adjustments to Work Order[2] | (34.2) |
| Work Order as Adjusted | 250.6 |
| TELRIC[3] Adjustments | 37.5 |
| TELRIC Costs | 288.1 |
| Less: Allocated to Bell Atlantic South | (84.3) |
| Less: Allocated to N. England Tel. | (78.3) |
| Amount to be Recovered in New York | 125.4 |

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Footnote is continued from previous page.

supporting documentation to verify that the amounts were accurately reported and the money was actually spent.

[1] Verizon charged $230 million of the $288 million to Operating Expenses. The remaining $58 million was incurred in 1999 and the company contends had to be charged to Account 1439, Deferred Charges pursuant to American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 98-1.

[2] Adjustments to Work Order consist of three individual adjustments. The two largest include employee benefits consistent with the labor charged to the work order ($11.8 million increase) and eliminate an estimate of maintenance costs included in the work order ($46.2 million decrease).

[3] Total Element Long Run Incremental Costs or TELRIC. Verizon's TELRIC adjustments result from the application of inflation and productivity factors ($1.7 million decrease) and inclusion of a portion of common overhead costs ($39.2 million increase).

Competitive Cost Onsets -- Party Comments

All the commenters urge the Commission to reject Verizon's request for recovery of OSS development costs outright, but, if the Commission finds the company's filing constitutes a prima facie showing, the filing should be the subject of full evidentiary hearings. The AG offers the alternative of deferring the cost recovery request, for resolution with BA-NY's pending exogenous cost request, in the proceeding to consider the company's proposals for extension of, or successor to the PRP, or in a combined proceeding to address all the issues.

The CLECs note that OSS is an unbundled network element (UNE) under the FCC's Local Competition Order and the costs requested for recovery, therefore, must be based on the current, most efficient technology (i.e., TELRIC). The CLECs contend Verizon's filing fails to establish that the claimed OSS costs constitute forward-looking economic costs and instead simply reflects whatever out-of-pocket expenses Verizon claims to have incurred for transitioning its OSS to a multi-carrier environment. They also argue that the company's recent admissions in ongoing collaborative meetings with CLECs and Staff regarding significant deficiencies in its OSS systems show that Verizon's claimed OSS development work efforts do not reflect efficient processes in material respects. Also, the wholly unrefuted Phase 2 record evidence demonstrated that Verizon's existing, embedded OSS was operating inefficiently.

CPB similarly argues that, to be eligible to recover OSS costs, Verizon must demonstrate that its OSS perform as intended and that the costs incurred are legitimate and required to open its network to competition. CPB also points to the ongoing collaborative meetings with CLECs and Staff regarding significant deficiencies to support its contention that the company has not met this requirement. CPB claims Verizon itself has acknowledged that its OSS did not perform as intended. CPB concludes that since the costs identified by the company are for OSS that have proven to be deficient, the Commission's additional cost quantification requirements -- whether the costs reflect TELRIC principles and whether such costs were incurred to benefit Verizon -- cannot be assessed.

As to the company's offer to spread OSS cost recovery over all access lines, CPB asserts that Verizon must show that the OSS costs satisfy the exogenous cost provision of the Performance Regulatory Plan. CPB holds that the company has not satisfied this requirement, as the costs are not the result of separation rule changes, Commission mandates or legislative tax changes. Therefore, Verizon cannot recover the OSS costs from its access line customers.

Competitive Cost Onsets -- Staff Adjustments

Staff is treating the OSS development costs as a cost onset incurred to open the wholesale market. Regarding OSS deficiencies, they have now been rectified and Verizon has incurred substantial penalties. Staff's analysis assumes no additional costs related to the implementation of OSS fixes will be sought.

Our analysis indicates that at least two adjustments are needed. The first relates to the company's adjustment to eliminate maintenance costs included in the amounts charged to the work order. Verizon claimed the adjustment was calculated by applying a factor of 15% to the initial development expense for the appropriate years. The company also stated the 15% is a factor which has been used internally for planning purposes of other Verizon software projects, and is supported by numerous industry sources as a reasonable estimate.[1] However, the Commission rejected the same 15% factor in Phase 2 of the UNE proceeding and used a 10% factor instead.[2] While Verizon again proposes the 15% factor in the proceeding reexamining the company's UNE rates (Case 98-C-1357), it would be premature to conclude the Commission will accept it. Therefore, we recommend the 10% factor be used for determining the OSS development costs eligible for recovery.

Our second proposed adjustment would reject Verizon's inclusion of about $37.5 million for common overheads,[3] determined by applying a factor of 1.1576 to the adjusted expenses at the end of the cost calculation. This is a novel approach being proposed by the company for the first time in the proceeding reexamining Verizon's UNE rates.[4] The company's current UNE rates recover common overheads by applying a factor to investments. The expenses at issue were incurred before the new methodology will be reflected in Verizon's UNE rates. As a result, applying the new methodology to them will result in a double recovery of costs as the investment base for determining the common overhead factor in the first UNE proceeding was the company's plant in 1995, did not include any OSS. Therefore, Verizon's proposal to include common overheads should be rejected at this time in order to avoid a

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[1] Verizon December 22, 1999 Panel Testimony, p. 35.

[2] Cases 95-C-0657, et al., Opinion No. 97-19 (issued December 22, 1997), pp. 34-36.

[3] Common Overheads include such expenses as Human Resources, Legal, and Executive as well as expenses associated with Special Pension Enhancement in Bell Atlantic-North.

[4] The 1.1576 factor was an estimate made in the December 22, 1999 filing. The factor reflected in the company's February 7, 2000 filing in Module 3 of the second UNE proceeding was 1.1195.

double count of common overhead expenses.

Competitive Cost Onsets -- Conclusion

The impact of our proposed adjustments reduces the company's estimate from $128.2 million to $115.8 million - a reduction of $12.4 million.

**Staff Adjustments to Verizon Competitive Cost Onsets**
**($ Millions)**

| | OSS | Other | Total |
|---|---|---|---|
| Competitive Cost Onsets Per Company | $125.4 | $2.8 | $128.2 |
| Staff Adjustments | | | |
| Reflect 10% vs. 15% Maint.factor | 5.1 | NA | 5.1 |
| Eliminate Common Overheads | -17.1 | -0.4 | -17.5 |
| Competitive Cost Onsets Per Staff | $113.4 | $2.4 | $115.8 |

## V. EXOGENOUS COSTS

Exogenous Costs -- Verizon Position

Until its most recent (June 1, 2000) exogenous cost filing, Verizon has submitted annual accounting of its exogenous costs but not actually sought recovery of them, because it had not been able to calculate merger savings by which the costs should be offset. Having made its BA/NYNEX merger savings filing in December 1999, the company believes it has met the prerequisites to seek recovery of exogenous costs.

The most recent data submitted by Verizon on exogenous costs was contained in the June 1, 2000 filing. Verizon's filing presents two categories of exogenous costs: a) costs subject to the $6 million threshold; and b) costs not subject to the $6 million threshold. The $6 million threshold relates to the fact that, subject to certain exceptions, the company may recover net exogenous increases in excess of $6 million annually and must flow through net decreases in excess of $6 million annually.

In total, the company seeks recovery of $646 million as exogenous costs due to PSC mandates. These costs include costs associated primarily with reciprocal compensation ($531 million or 82% of the total request) and reductions in carrier access charges ($77 million or 12% percent of the total request). Additional requests include recovery for reductions in link rates, area code splits, directory listings, reductions to inside wire charges (for ISDN) link rates and the costs associated with retaining KPMG to conduct a test of the Verizon OSS interfaces. Verizon also suggests that to the extent OSS costs are not recovered in UNE rates, these costs should be recoverable as exogenous costs.

Exogenous Costs -- Party Comments

Copies of the June 1, 2000 exogenous cost filing were provided to all active parties in Case 92-C-0665. However, no comments were received from any party. CPB did comment on Verizon's June 1, 1999 exogenous cost filing in July 1999. Many of the costs in the June 2000 exogenous costs filing fall into the same categories as those submitted in June 1999, so that CPB's comments are equally applicable to the most recent filing. CPB's position regarding the exogenous costs is consistent with Staff's view. CPB argues that of the $490 million requested by Verizon as exogenous in 1999, $444 (90%) should be rejected because the costs do not satisfy the exogenous cost standard of the PRP. The only category of costs CPB accepts as exogenous are those associated with the carrier access charge reduction. CPB concludes that the Commission has already determined that the company would be able to recover these costs.

Exogenous Costs -- Staff Adjustments[1]

**Reciprocal Compensation - $531 Million**

Verizon estimates reciprocal compensation payments to be $531 million during the first five years of the PRP. The company claims that two orders issued by the Commission in Case 97-C-1275 that directed Verizon to pay reciprocal compensation on calls delivered to Internet Service Providers (ISP) were Commission mandates.[2] Verizon points to a February 26, 1999 FCC Order that concluded that calls to the internet are not local in jurisdiction and therefore, are not subject to the New York Commission's jurisdiction.[3] As a result, Verizon has classified these payments as exogenous costs and recoverable from consumers.

Staff disagrees with the company's characterization. First, Verizon proposed and subsequently agreed to reciprocal compensation as a condition of the PRP (termed local interconnection compensation in the order).[4] Although we agree

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[1] A chart showing Verizon's requested exogenous costs and Staff's accepted exogenous costs is included as Appendix B.

[2] Case 97-C-1275, Order Denying Petition and Instituting Proceeding (issued July 17, 1997) and Order Closing Proceeding (issued March 19, 1998).

[3] CC Docket No. 96-98, Local Competition Provisions of the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic, Declaratory Ruling and Notice of Proposed Rulemaking (released February 26, 1999).

[4] Case 92-C-0665 - Performance-Based Incentive Regulatory Plans for New York Telephone Company - Track II, Order Approving Performance Regulatory Plan Subject to Modification (issued June 16, 1995), p. 15.

that reciprocal compensation payments have substantially increased since the beginning the PRP (due to the growth of the Internet), that fact alone has no bearing on classifying these costs as exogenous. Indeed, increased competition was a fundamental expectation of the PRP.

Second, Verizon's interpretation of the FCC's February 1999 ruling is too narrow. While the ruling stated that Internet calls are not local in jurisdiction, it also stated that existing reciprocal compensation agreements should be honored and directed state commissions to arbitrate disputes over reciprocal compensation. This implies that these payments are the result of arms length negotiations between two parties and not the result of a Commission mandate. In any event, the FCC's February 1999 ruling was vacated and remanded, leaving calls to the Internet local and subject to reciprocal compensation pursuant to federal law.

Finally, the company's filing failed to address the Commission's Order that reexamined reciprocal compensation rates, including ISP bound traffic.[1] In that proceeding, the Commission observed that high volume convergent traffic (which includes Internet-bound traffic) has different cost characteristics and should be compensated at a lower rate. The Commission also determined that traffic in excess of 3:1 ratio is presumed to be high volume, convergent traffic, although this presumption may be rebutted. An argument could be made that this Commission order resulted in cost savings and should be used to offset Staff's quantification of exogenous costs.

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[1] Case 99-C-0529, Order Instituting Proceeding to Reexamine Reciprocal Compensation (issued April 15, 1999).

**Access Charge Reductions ($77 Million)**

Although we agree with Verizon that access charge reductions qualify as an exogenous cost, we disagree with the company's calculation. Verizon offsets this reduction by the increased support for the federal lifeline program (approximately $23 million per year). Although this treatment is consistent with the Access Charge Opinion,[1] we recommend that the company continue to defer these revenues for the future benefit of customers. As discussed above, our position is that merger savings provide the company with sufficient funding to offset the costs relating to access charge reductions. If this Staff adjustment were not accepted, the company would be collecting this exogenous cost twice -- once through the increased lifeline support and once through the merger savings. Staff's adjustment increases Verizon's exogenous cost request for access charge reductions by $44 million to $121 million and increases deferred revenues from increased federal lifeline support by the same amount.

**Link Rate Reductions ($21 Million)**

The company estimates PRP costs of $21 million as a result of the lost revenues related to reduced link rates. In April 1997, the Commission ordered link rates reduced from $22.85 per month to $12.49 for areas encompassing approximately 70% of all loops and $19.24 per month for the rest of the company's service territory.[2] Under the Telecommunications Act of 1996

[1] Opinion No. 98-10, Cases 94-C-0095 and 28425, Opinion and Order Establishing Access Charges for New York Telephone and Instituting a Targeted Accessibility Fund (Issued June 2, 1998), p.37.

[2] Cases 95-C-0657 et al., First Group of Network Elements, Opinion 97-2 (issued April 1, 1997).

(1996 Act), the FCC required incumbent local exchange companies (ILECs) to provide unbundled network elements, including links, at a price based upon Total Element Long Range Incremental Costs (TELRIC).[1] The $21 million represents the difference between TELRIC costs and Verizon's embedded costs. These costs should be denied recovery. The revenue loss from the reduction in link rates does not qualify as an exogenous cost according to Section IV (G)(3) of the PRP, which defines exogenous changes as limited to the effects of jurisdictional separations rules changes, PSC mandates, and legislative tax changes affecting only utilities. We note that the $21 million might understate the actual shortfall due to an undercount of lines lost. On the other hand, we also note that a portion of the $20 million should be allocated to the interstate jurisdiction for recovery since the UNE rates cover both the intra- and inter-state TELRIC costs. In addition, the FCC's May 31st Order 00-193 on access charge reform and universal service may provide for partial recovery of the shortfall that Verizon seeks to recover here.[2] Verizon has not made an adequate showing of the allocation of these shortfalls or why they are not being recovered elsewhere.

**KPMG Costs ($23 Million)**

Verizon requests that the costs it incurred to hire KPMG to conduct a third party test of Verizon OSS interface be considered exogenous under the PRP. Verizon states that two

[1] Docket Nos. 96-98 and 95-105, First Report and Order (released August 8, 1996).

[2] CC Docket Nos. 96-262, 94-1, 99-249,96-45, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long-Distance Users and Federal-State Joint Board on Universal Service.

Commission orders "required" it to retain KPMG to assist the Commission in its audit of Verizon's OSS.

Staff rejects the argument that the KPMG costs are exogenous. The company proposed the hiring of KPMG in its April 6, 1998 Prefiling Statement (PFS) and agreed to bear the cost. The PFS is clear on this issue:

> Bell Atlantic-NY understands and agrees that this test will be conducted under the supervision of DPS staff, in accordance with the RFP issued by the DPS on March 6, 1999 and attached hereto as Appendix 4. Although **Bell Atlantic-NY commits to paying the costs of the third party test**, the consultant(s) will report directly to DPS staff, and will have no reporting relationship with Bell Atlantic-NY.[1] [Emphasis added].

The company had previously provided insufficient evidence to demonstrate parity of access to its OSS.[2] The hiring of an independent third party to test the OSS was sought by Verizon to demonstrate parity access in conjunction with its efforts to enter the long distance market. Such costs should not be considered exogenous.

Exogenous Costs - Conclusion

Staff concludes that of $646 million classified as "exogenous" by Verizon, only $121 million (28%) should be considered exogenous -- a reduction of $525 million.

Although Staff has made significant adjustments to the

[1] Case 97-C-271, Pre-Filing Statement of Bell Atlantic-New York, April 6, 1998, Page 33.

[2] Case 97-C-0271, Ruling Concerning the Status of the Record, Issued July 8, 1997.

company's exogenous cost filings, absent a rate reduction, Verizon will still recover the majority of the disallowed exogenous costs. As shown in Appendix B, Staff's estimate of merger cost savings exceeds Staff's accepted exogenous costs by $844 million during the PRP. Consequently, Verizon will be provided adequate funding to pay for most of the company's claimed exogenous costs.

Finally, despite the Commission's directive in the Bell Atlantic/GTE merger order requiring Verizon to identify overall Bell Atlantic/GTE merger-related savings in connection with Verizon's request for recovery of exogenous costs, the company has not identified such savings in their June 1, 2000 filing. FCC approval for the Bell Atlantic/GTE merger was not received until June 16, 2000. The company should identify in its comments in this case merger savings associated with the GTE merger.

## VI. ACCOUNTING

In Track I of the PRP, the Commission authorized Verizon to implement two accounting plans: The Regulatory Asset Recovery (RAR) and Pension/Post-retirement Benefits Other Than Pensions (OPEB) plans.[1] These plans allowed the company to use an existing revenue stream and expense credits to recover certain Commission-approved regulatory assets. Both plans were updated during the fourth year of the PRP because the plans' targeted assets had been completely recovered.[2] In that Order, the Commission directed the company to file plans for the final resolution of the RAR and

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[1] Opinion No. 94-2, Cases 92-C-0665, et al., (issued January 28, 1994).

[2] Case 92-C-0665 - Order Directing the Accounting for Certain Revenue Streams and Expense Credits (issued August 12, 1999), Page 8.

pension/OPEB plans. Verizon was also directed to provide an accounting for pension costs that preserve pension gains for the benefit of New York ratepayers. The company responded to that order in its June filing renewing the PRP.

RAR Accounting -- Verizon's Position

Verizon proposes that the Commission use the annual $53 million revenue stream and accumulated deferred revenues associated with the RAR Plan to offset a portion of the exogenous costs Verizon incurred during the Plan. The company believes the proposal is reasonable for two reasons. First, the proposal balances the interests of the consumer and Verizon since the recovery of the company's exogenous costs will be substantially reduced. Second, the proposal would provide Verizon with some small improvement in its financial condition. The company claims that its returns during the Plan have been extremely poor and were well below the possible earning levels that the Commission envisioned during the PRP. Verizon has quantified the cumulative revenue shortfall to be over $2 billion for the first 4½ years of the PRP.

RAR Accounting -- Staff's Adjustments

Staff disagrees with the company that it should be allowed to use the revenue stream associated with the RAR Plan to offset exogenous costs. As stated above, our analysis of merger savings and exogenous costs suggest that the merger savings exceed Staff's estimate of exogenous costs. Thus, Verizon already has a recovery mechanism in place to recover Staff's estimate of exogenous costs.

Although we agree with the company that its earnings have been below expectations during the PRP, our cursory analysis indicates it has overestimated the revenue shortfall. First, Verizon has included $230 million of service quality penalties paid to customers and affiliate audit refunds as part of the shortfall. These payments should not be recovered by the company and should be removed from the company's calculation. Second, the company's revenue shortfall includes $202 million in costs that the Commission disallowed in Track I of the PRP (e.g. executive compensation, marketing). In order to have consistency with the PRP expectations, Verizon should have adjusted the shortfall for these adjustments.

Third, Verizon has included $370 million of one-time merger costs in the shortfall. Since these merger costs will produce benefits in the last 2½ years of the PRP (and beyond), the company should have considered these benefits in its calculation. Indeed, simple math indicates merger savings alone will allow the company to earn significantly above the historical levels for the last two years of the PRP.

Finally, some of Verizon's revenue shortfall stems from its failure to lower its personnel expenses, despite the inclusion of funding for staff reductions incorporated in the PRP. Verizon has spent $1.2 billion to encourage employees to leave the business since the beginning of the PRP. Despite these mammoth expenditures, the company's force levels in the fifth year of the PRP remain virtually unchanged from the beginning of the Plan.[1] Such results bring into question the purpose of these expenditures, because at a time when the force level was actually increasing (up through the merger), Verizon continued to incur

[1] If the Bell Atlantic and NYNEX merger had not occurred, it is likely the force levels would have increased since the beginning of the PRP.

costs associated with a force reduction program. The company states the force levels were not reduced because the resources were needed to support its customer service improvement initiative and the unexpected growth in access lines and resulting business volumes. It is also probable that the Telecommunications Act of 1996 and Verizon's desire to enter the long distance markets contributed to the higher force levels. At any rate, the company should have re-examined its force reduction program and related cost when it became obvious that the forecasted reductions could not be achieved.

RAR Accounting -- Conclusion

After excluding these items from the company's claimed shortfall, Verizon's adjusted shortfall in revenues is almost nil for the first 4½ years of the PRP. This relatively small difference is an insufficient rationale for allowing the company to retain the $53 million annual revenue stream, particularly since one goal of the PRP was to transition Verizon from cost-based regulation to incentive-based regulation.

Pension Accounting - Verizon Filing

The company provided a summary of pension and OPEB activity from 1993 through 1999. Verizon claims this summary shows the company has accounted for pensions consistent with its Commission-approved accounting plan and Commission's Statement of Policy.[1] Verizon also commits to continue the accounting called for by the Verizon Plan until the end of the PRP.

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[1] Case 91-M-0890, Statement of Policy on Pensions and Post-Retirement Benefits Other than Pensions (issued September 7, 1993).

Pension Accounting -- Staff's Position

Although the company provided an accounting of its pension plan, Verizon provided no explanation of how pension gains will be preserved for the benefit of New York ratepayers. Verizon also did not include a plan on the final disposition of the expense credits and revenue streams associated with its Pension/OPEB plan as ordered by the Commission.

Pension Accounting -- Conclusion

We are concerned that the company has not complied with the Commission's August 12, 1999 Order concerning the pension accounting plan. Staff is in the process of obtaining more information on this issue. No Commission action is recommended at this time, pending further staff investigation.

## VII. CONCLUSION

Verizon has requested $128 million in competitive cost onsets and $646 million in exogenous costs. It has also proposed to use the revenue stream of $53 million associated with the Regulatory Asset Recovery Plans as an offset to exogenous costs. However, the company's estimated cost savings from the BA/NYNEX merger are significantly understated, and the exogenous and competitive onset costs are similarly overstated. Staff's findings indicate that the company's request for additional recovery related to both the competitive cost onsets and exogenous costs should be rejected, because the cost savings attributable to the BA/NYNEX merger, as adjusted, are sufficient to provide for full recovery of those adjusted costs. Further, Staff recommends that the Commission reject the company's proposal to use the revenue stream of $53 million associated with the Regulatory Asset Recovery Plans as an offset to exogenous costs since merger savings are available to offset applicable exogenous costs.

# APPENDICES

Appendix A -- Description of Other Competitive Cost Onsets

Appendix B -- Staff Vs Verizon on OSS, Exogenous Cost and Merger Savings

Appendix C -- Bell Atlantic/NYNEX 1997-2000 Merger Cost Savings – Summary of BA-NY Intrastate Savings

**Description of Other Competitive Cost Onsets**

**Product and Service Availability (PSA)** - a service that provides information as to what retail products and services are available in a particular wire center. The PSA information is identified to each specific NPA-NXX as well as to the wire center, to enable the customer representative to determine what specific services are available to a particular end-user customer. Currently, this information is available on a per-transaction basis as one of the pre-ordering functionalities through the access to OSS discussed in earlier sections of this testimony. The PSA File Download capability will provide carriers with the alternative of requesting a "dump" of the entire PSA database.

**Street Address Guide (SAG)** - a service that provides information on valid street address ranges. The information is extracted from the PREMIS system and made available on a regular basis to carriers via an FTP site on the World Wide Web. The FTP download is a standard data transfer technology in all commercially available computer and data systems.

**Directory Assistance Listings Transfer (DALT)** - provides other carriers with a copy of BA-NY's entire DA database in machine-readable form. DALT provides a copy of BA-NY's DA database using the latest electronic file transfer techniques.

**ATLAS Display of Listings** - a service that provides carriers with on-line real-time access to the Company's White Pages listings database. This database includes information on formatting and listings as they appear in printed directories. Carriers desire this access in order to: (1) verify the accuracy of their own end users' listings, and (2) check the sequencing of captioned package listings.

**Advanced Intelligent Network (AIN) Service Creation Access Ports** - AIN is a service platform that utilizes the SS7 signaling network. It consists of a database that can intelligently route calls or provide other intelligent functionalities. This database is known as an Intelligent Signaling Control Point, or simply an AIN ISCP. The mechanism to query the ISCP is known as an AIN trigger and occurs in an end office. End offices that have the ability to trigger the ISCP are called Service Switching Points (SSP). AIN Service Creation gives a carrier the ability to create new AIN services of its own design using BA-NY's AIN network. An AIN Service Creation Access Port gives the carrier access to the Service Creation Environment (SCE) through a dedicated access port. These costs include the costs associated with the security workstation, identification cards and Right-to-Use (RTU) fees.

**Operator Services** - capabilities for Direct Access to Directory Assistance ("DADA"), White Page listings update, and Branding/Unbranding. The Company has identified approximately $3.4 million in one-time expenses.

Bell Atlantic - New York
Exogenous Costs; OSS Costs and Merger Savings
Company vs Staff
PRP YRS 8/31/96 through 8/31/02

| | Actual | | | | | Forecast (1) | | Actual | Total |
|---|---|---|---|---|---|---|---|---|---|
| | 8/31/96 | 8/31/97 | 8/31/98 | 8/31/99 | 8/31/00 | 8/31/01 | 8/31/02 | 9/96-8/00 | 9/96-8/02 |
| **Per Company** | | | | | | | | | |
| **Exogenous and OSS** | | | | | | | | | |
| Reciprocal Compensation | | | | 187 | 344 | 344 | 344 | 531 | 1,219 |
| Access Charge Reduction | | | | 58 | 19 | 19 | 19 | 77 | 115 |
| Reduction in Link Rates | | 2 | 3 | 4 | 12 | 12 | 12 | 21 | 45 |
| KPMG Costs | | | | 23 | | | | 23 | 23 |
| Other | | 0 | | (6) | 0 | 0 | 0 | (6) | (6) |
| Subtotal | 0 | 2 | 3 | 266 | 375 | 375 | 375 | 646 | 1,396 |
| OSS Costs | 15 | 26 | 27 | 40 | 20 | 0 | 0 | 128 | 128 |
| Total | 15 | 28 | 30 | 306 | 395 | 375 | 375 | 774 | 1,524 |
| **Merger Related** | | | | | | | | | |
| Revenue Enhancements | | | | | | | | | |
| Expense Savings | | | 20 | (49) | (112) | (219) | (220) | (141) | (580) |
| Commitment Costs | | | 47 | 84 | 116 | 134 | 146 | 247 | 527 |
| Total | 0 | 0 | 67 | 35 | 4 | (85) | (74) | 106 | (53) |
| **Net Costs after Merger** | **15** | **28** | **97** | **341** | **399** | **290** | **301** | **880** | **1,471** |
| **Per Staff** | | | | | | | | | |
| **Exogenous and OSS** | | | | | | | | | |
| Reciprocal Compensation | | | | | | | | 0 | 0 |
| Access Charge Reduction | | | | 81 | 40 | 40 | 40 | 121 | 201 |
| Reduction in Link Rates | | | | | | | | 0 | 0 |
| KPMG Costs | | | | | | | | 0 | 0 |
| Other | | | | | | | | 0 | 0 |
| Subtotal | 0 | 0 | 0 | 81 | 40 | 40 | 40 | 121 | 201 |
| OSS Costs | 13 | 23 | 24 | 39 | 17 | 0 | 0 | 116 | 116 |
| Total | 13 | 23 | 24 | 120 | 57 | 40 | 40 | 237 | 317 |
| **Merger Related** | | | | | | | | | |
| Revenue Enhancements | | | | | (39) | (107) | (143) | (39) | (289) |
| Expense Savings | | | 12 | 37 | (153) | (382) | (386) | (104) | (872) |
| Commitment Costs | | | | | | | | 0 | 0 |
| Total | 0 | 0 | 12 | 37 | (192) | (489) | (529) | (143) | (1,161) |
| **Net Costs after Merger** | **13** | **23** | **36** | **157** | **(135)** | **(449)** | **(489)** | **94** | **(844)** |
| **Difference (Company vs Staff)** | | | | | | | | | |
| **Exogenous and OSS** | | | | | | | | | |
| Reciprocal Compensation | 0 | 0 | 0 | 187 | 344 | 344 | 344 | 531 | 1,219 |
| Access Charge Reduction | 0 | 0 | 0 | (23) | (21) | (21) | (21) | (44) | (86) |
| Reduction in Link Rates | 0 | 2 | 3 | 4 | 12 | 12 | 12 | 21 | 45 |
| KPMG Costs | 0 | 0 | 0 | 23 | 0 | 0 | 0 | 23 | 23 |
| Other | 0 | 0 | 0 | (6) | 0 | 0 | 0 | (6) | (6) |
| Subtotal | 0 | 2 | 3 | 185 | 335 | 335 | 335 | 525 | 1,195 |
| OSS Costs | 2 | 3 | 3 | 1 | 3 | 0 | 0 | 12 | 12 |
| Total | 2 | 5 | 6 | 186 | 338 | 335 | 335 | 537 | 1,207 |
| **Merger Related** | | | | | | | | | |
| Revenue Enhancements | 0 | 0 | 0 | 0 | 39 | 107 | 143 | 39 | 289 |
| Expense Savings | 0 | 0 | 8 | (86) | 41 | 163 | 166 | (37) | 292 |
| Commitment Costs | 0 | 0 | 47 | 84 | 116 | 134 | 146 | 247 | 527 |
| Total | 0 | 0 | 55 | (2) | 196 | 404 | 455 | 249 | 1,108 |
| **Net Costs after Merger** | **2** | **5** | **61** | **184** | **534** | **739** | **790** | **786** | **2,315** |

(1) Forecast of exogenous costs assumes no change from the fifth year of the PRP.